SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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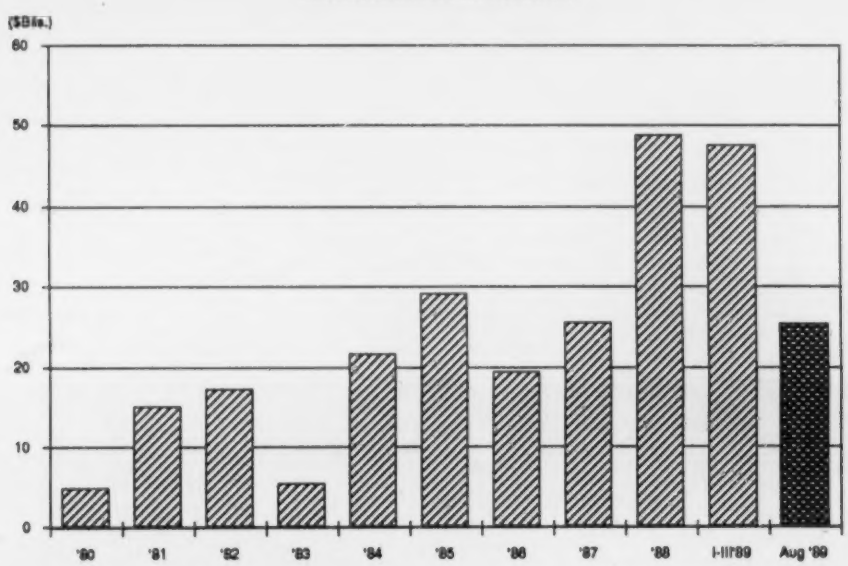
When One Month Makes A Year

Once in a while, we are reminded of the enormous amounts of worldwide capital which is free to be invested. August was such a reminder. In August alone, foreign investors made net purchases of an unprecedented $22 billion in U.S. Treasury Bonds and Notes; and over $25 billion for the 3Q89. In comparison, just consider, until 1985 the largest net purchase total for a year was $21.5 billion (1984). Both official institutions and private investors took part, making net purchases in August of $10 billion and $12 billion. U.K. investors made net purchases of $11.2 billion, while German investors and OPEC made net acquisitions of $5.6 billion and $4.8 billion, respectively. Surprisingly, Japanese investors -- major buyers of Treasuries in the past -- were net sellers in the 3Q89.

Net Investment in U.S. Treasuries

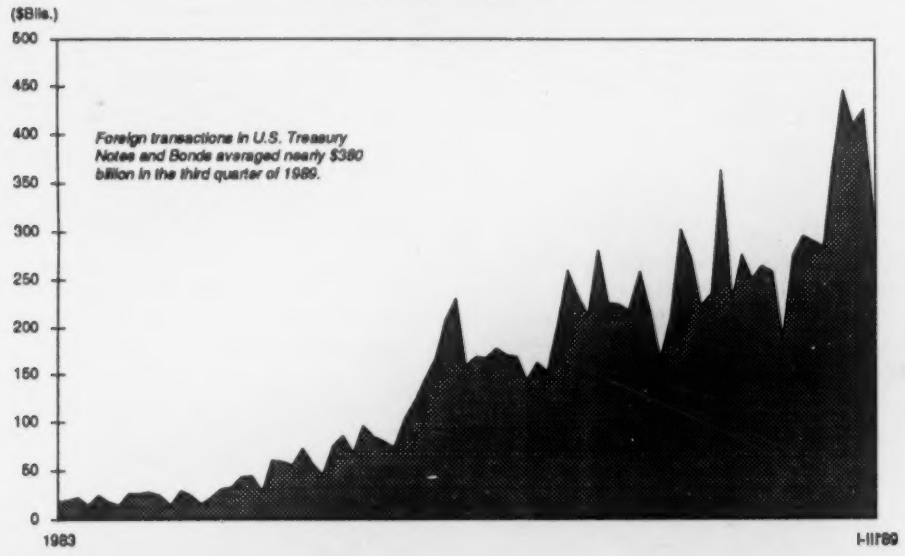


While the reasons for the investment in U.S. Treasury bonds are plenty, none seems particularly compelling enough to account for this massive inflow of capital. Among the factors were the recovery of the Dow to a record high, an improving trade outlook, an increase in the U.S. government's statutory debt limit for the first time since September 1987, a Fed decision not to withhold or delay primary dealerships from foreign firms, and evidence from the Fed's "Beige Book" showing a "soft landing" for the U.S. economy.

We discussed the magnitude of the August number with the U.S. Treasury. While data are preliminary, Treasury informed us that the August number was, after checking, accurate.

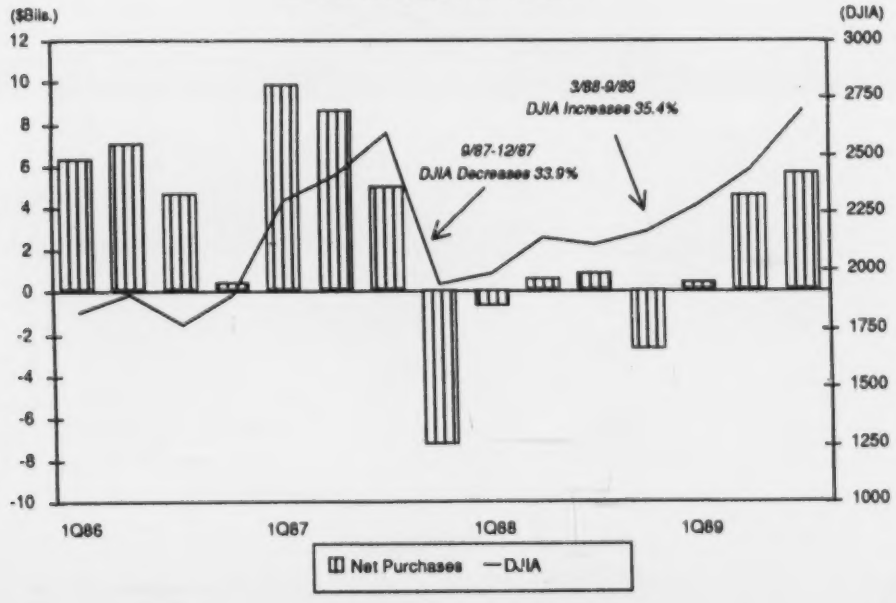
In addition, instead of the usual summer doldrums, gross transactions reached near record heights during the 3Q89, with August's activity topping $426 billion; just below the $446 billion traded in July. Moreover, August's activity exceeded any year's activity prior to 1984's $450.7 billion.

Gross Transactions in U.S. Treasury Bond & Notes



Unusually high activity was also exhibited by U.S. primary dealers, exceeding $140 billion on a daily basis for the first two and one half weeks in August. The strength in activity may have been in response to some economic reports in August, which indicated, unlike the Fed's "Beige Book", that the U.S. economy was healthier than previously thought.

Foreign Investors Commit Increasing Amounts Of Capital To U.S. Equities



Capital inflows were not limited to Treasury notes and bonds. As the Dow broke through pre-crash highs, equities, too, attracted foreign interest, reaching pre-crash levels. Net purchases in the 3Q89 totalled $5.7 billion, a level not exceeded since the $8.6 billion in 2Q87. From 1986 through the first three quarters of 1987, net purchases averaged $6.2 billion per quarter. In sharp contrast, foreign investors averaged quarterly net sales of $626 million from 4Q87 to 2Q89. While fourth quarter data is not available, it will be interesting to see what lesson, if any, foreign investors learned from the 1987 Crash. Those, who used the ensuing months in 1987-88 to purchase "marked-down" equities, profited handsomely.

More details will be available in the complete 3Q89 *Foreign Activity Report.*

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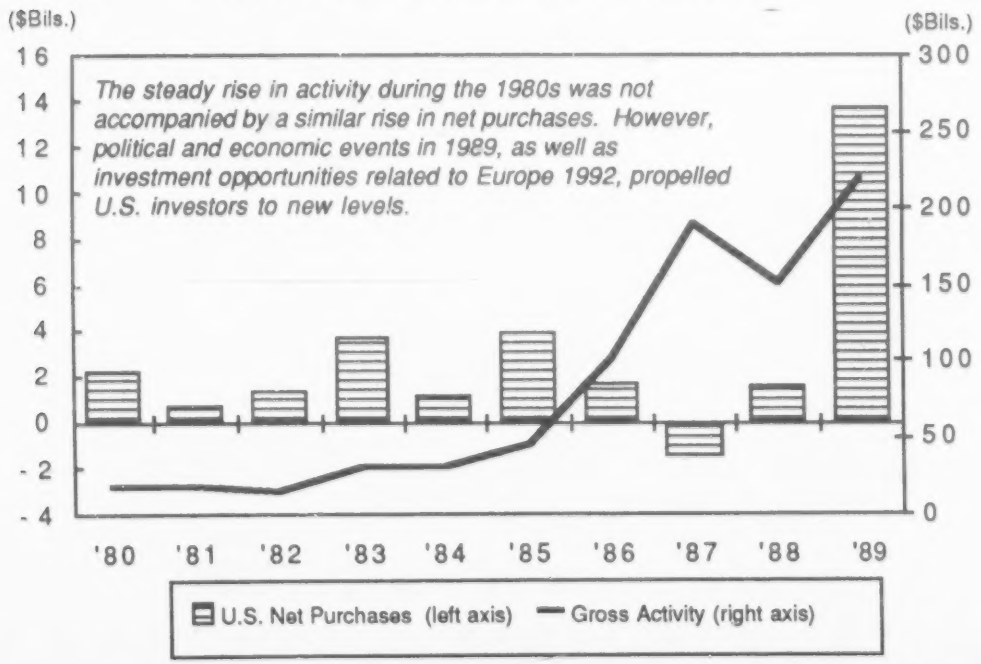
Vol. XIII, No. II

March 22, 1990

Maybe Foreign Markets Aren't So Foreign Anymore

With a strengthening U.S. dollar easing the way, political and economic transformations around the world, particularly in Europe, led U.S. investors to make net purchases of a record *$13.7 billion* in 1989. The 1989 total is some three and one-half times greater than the previous high of *$3.9 billion* in 1985. Interestingly, 1989 is the only year during the 1980s that U.S. net purchases of foreign equities exceeded foreign net purchases of U.S. equities. (In 1984 and 1988, foreign investors made net sales.) Moreover, gross transactions in 1989 totalled a record $220 billion, a 16% increase over 1987's record $190 billion. The increased U.S. commitment to foreign equities took place while world equity markets (excluding the U.S.) posted a modest 10.3% gain. Contrasted with the 26% increase in the U.S. market, we contend that the unparalleled nature of this investment is for longer-run considerations.

1989: The Year Of The U.S. Equity Investor



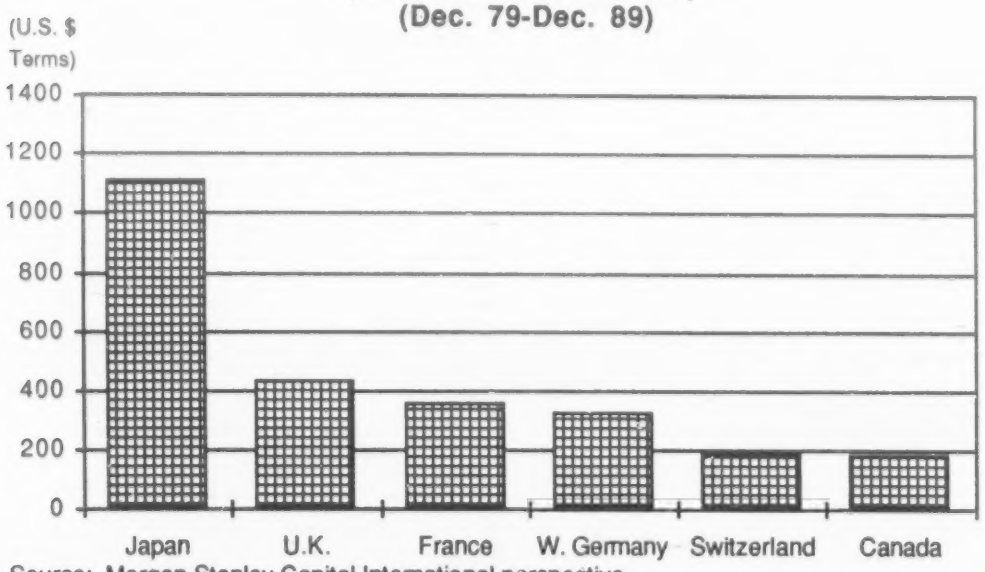
On a quarterly basis, U.S. investors made $4.27 billion of net purchases in the fourth quarter, nearly equalling the record $4.29 billion made in 2Q89. As the Yen weakened, increased U.S. purchasing power led to a $1 billion commitment to the Japanese equities. With the Tokyo market under pressure from rising interest rates, we believe the activity in the Japanese market represented a buying opportunity for those U.S. investors underweighted in Japanese stocks.

Spurred on by rapidly moving events in Europe, U.S. investors made net purchases of $2.5 billion in Europe in 4Q89. New highs were reached in France, $474 million, and West Germany, $555 million; M&A activity in the former, and developments in Eastern Europe in the latter, played no small part in attracting these flows. Perhaps of more interest are indications of the U.S. investors' interest in all EC equities. In 1989, net purchases of equities in EC Member States totalled $8.9 billion, exceeding 1987's previous record of $2.8 billion. In addition, U.S. investors also increased direct investment into Europe. On an annualized basis, U.S. investors increased their direct investments in the EC by some $16 billion; this compares to $4.4 billion in 1988. So while EC 1992 might seem distant to some, U.S. investors are clearly gearing up to benefit from this new economic powerhouse.

The Decade That Was

With the decade closed, it is interesting to compare the allocation of U.S. funds to overseas equity markets to the performance, in U.S. dollars, of these markets. From 1980 to 1989, U.S. investors made net purchases of over $25 billion of foreign equities. Over half of these, net purchases, however, were made in 1989 alone.

Increase in Foreign Equity Market Prices
(Net Dividends Included)
(Dec. 79-Dec. 89)



Source: Morgan Stanley Capital International perspective

The U.K. was the main recipient of U.S. equity investment, with equity investments totalling $11.8 billion (or 47% of total net equity investment). Despite the

meteoric rise of Japanese stocks since 1980, U.S. investors lost out for the most part, making sales of nearly $4 billion.

Canadian equities were the second largest recipient of U.S. dollars during the 1980s, with net investment of $5.2 billion. Swiss stocks, also attracted U.S. attention, with net purchases equalling about $3.8 billion. U.S. investment in Swiss stocks was fairly steady throughout the 1980s, with U.S. investors making net sales in just five quarters, less than that of any other major country. In light of the restrictions on ownership of Swiss stocks by foreign investors, we find this of interest and believe U.S. investment would increase with the elimination of restrictive practices. Finally, French equities also attracted $3.0 billion in U.S. funds.

When we compared U.S. investment flows to the increase in overseas equity prices (U.S. dollars), we noticed that the market which performed the best, the Japanese market, was the only major market in which U.S. investors withdrew funds. For the record, the Japanese market increased by over 1100% in the 1980s, or at a compound annual growth rate of 28%. Nevertheless, while a poor investment decision for the 1980s, this posture appears prudent given current events in the Tokyo markets which have forced Japanese stocks down by over 30% (U.S. $ Terms) since the beginning of the year.

The beneficiary of the lion's share of U.S. capital was the U.K. equity market, which increased over 430% in the 1980s; not bad, but far behind the Japanese market. U.S. investors in Canadian equities received a relatively disappointing 178% increase in the 1980s, the smallest increase among the six countries analyzed.

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